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The Japanese Cooperative Sector

**Mark Klinedinst
and
Hitomi Sato**

The modern history of Japanese cooperatives began in the Meiji Era of the nineteenth century. Today in Japan, more than 30 million people are members in cooperatives.¹ The cooperative sector is especially strong in agriculture and related industries, and cooperatives are also found in the retail distribution of food, medical care, insurance, housing, universities, and in the financial industry as investors and with credit unions. While the range of industries where cooperatives are found is similar in some ways to that of the United States and other industrialized countries, the extensive penetration of one sector—agriculture—is neither paralleled in the United States nor in other industrialized countries. The strength of involvement in one sector of the economy in Japan is both a strength, and in light of recent trade pressure to lift agricultural tariffs, a potentially dangerous strategy.

History of Japanese Cooperatives

The history of cooperative associations in Japan goes back many years. During the Edo period (1603-1867), mutual assis-

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tance groups were started among less economically powerful individuals [Chikuji 1992, 375]. Ninomiya Sontoku (1787-1856) helped farmers set up rural credit associations in the mid-1800s. Also at this time, the beginning of Meiji Era, many types of industry cooperatives were developed. The most active cooperatives were the silk and tea retail cooperatives. Their main purpose was to improve product quality and increase exports. In addition to these cooperatives, there were rural purchasing cooperatives.

In 1900, the Industry Cooperative Law was passed in parliament in an attempt to adapt some of the strengths of the German guild system as perceived by observers sent to the West by the Meiji government. Until the Japan-Russian War (1906), industry cooperatives did not develop as expected. However, after the war, the government put substantial effort into the development of agricultural cooperatives. These cooperatives, following in the guild framework, were to serve four main functions: credit, marketing, purchasing, and management. This broad mandate can still be seen in the extensive range of services offered by Japanese agricultural cooperatives.

In 1921, the industry cooperative law was improved, and the Central Industry Cooperative Bank (Norinchukin) was established by the government in 1923. The industrial cooperatives joined the International Cooperative Association (ICA) in 1922. In 1930, the Showa agricultural recession caused farmers serious problems. To improve the situation, the government set up the five-year Industry Cooperative Development Plan and encouraged every farmer to join a cooperative. On the other hand, because cooperatives focused on only agriculture, small crafts people fought against the establishment of cooperatives.

In spite of the recession and anti-cooperative campaigns, agricultural cooperatives were extensively developed. The best-known leader, Kotaro Sengoku, insisted that the development of cooperatives would eliminate the contradictions of capitalism and contribute to its development.

In 1938, cooperatives faced a turning point. The government tried to take advantage of the cooperatives as tools to organize citizens during the hard times caused by the war between Japan and China and then during World War II. Cooperatives, as well as other cooperative-like organizations (e.g., Agricultural Association, Stockbreeder Association, Tea Industry Cooperative, and so on), were brought into an organization called the Agricultural Associa-

tion in 1943. The Agricultural Association was not democratic; the government took advantage of the agricultural cooperatives to organize people and to ensure a resource base for the war. Members did not have the right to join or leave the agricultural cooperative.

After World War II, the Agricultural Association became more democratic. However, it still failed to achieve the degree of democracy to which General Douglas MacArthur, Supreme Commander, Allied Powers (SCAP), directed. In 1945, SCAP and the government proceeded with the land reform revolution with the goal of eliminating the discrimination between a few large landowners and tenant farmers. This revolution significantly influenced the operations of cooperatives.

In 1947, the Agricultural Cooperative Law was established and encouraged the creation of local cooperatives. The wealth of the Agricultural Association was transferred to the agricultural cooperatives, hence the agricultural cooperatives were bound to the heritage of the former association. Moreover, in spite of the high speed of development, agricultural cooperatives suffered poor management and continuing deficits. In light of this situation, the Agricultural Cooperative Improvement Law was passed to increase financial support from the government. Other enabling legislation in the late 1940s led to the creation of forestry, fisheries, credit unions, and consumer co-ops [Japanese Joint Committee on Cooperatives 1992]. In 1956, the umbrella organization for most Japanese cooperatives, the Japanese Joint Committee on Cooperatives (JJC), was formed.

During the 1960s, with the significant growth of the Japanese economy, a number of cooperatives experienced rapid development. Especially noteworthy was the mutual insurance division, which increased its capital by 44 times within 15 years. However, since the oil shock in 1973, the growth rate of the Japanese economy has been at a lower level, and hence, the development of cooperatives also has been slower.

Recent Developments in Japanese Cooperatives

Today in Japan there are cooperatives in agriculture, insurance, food distribution, medicine, universities, and banking. The strongest and most diverse cooperatives are still the more than 3,600 agricultural cooperatives, or *nokyos*. The estimated worth of the *nokyos* is approximately \$450 billion [Eisenstodt

1991, 84]. The national federation of *nokyos*, Zen-noh, which helps in purchasing and marketing, by itself generated more than \$70 billion in revenue in 1992 [Zen-noh 1992, 2]. These cooperatives range from rice, fisheries, and timber industries to a central cooperative bank for agriculture, the Norinchukin Bank, with assets of more than \$355 billion. The worth and assets of these organizations are reflections of their dominance in particular sectors, e.g., *nokyos* control 95 percent of Japan's rice crop and 90 percent of the fertilizer market.

One of the most important operations of Japanese agricultural cooperatives is mutual credit and insurance, which mainly functions as a financier of projects to develop the agricultural industry. The agricultural cooperatives credit division includes the Central Agriculture Bank, or Norinchukin Bank, followed by the prefectural-level credit unions and the local agricultural cooperative. The most important feature of the system is that the customers are its only members. A regular member must be a farmer or an agriculturally related organization. An associate member is a resident of the area in which a certain local agricultural cooperative is located, many of whom may not be farmers.

The Norinchukin Bank was established to contribute to the development not only of agriculture, but also of fisheries and forestry. When it has excess capital, it invests in the stock or bond market. On the other hand, when it is short of capital, it can borrow money from the Bank of Japan.

The agricultural cooperative generates its revenue mainly by loans to individual borrowers, usually its members, and to the prefectural credit union. The income of farmers in Japan who are members of cooperatives usually is less than workers in industry. Acting as a rural development agency, the government makes loans to the farmers at a low interest rate through the cooperatives, which is called a *system loan*. Typical system loans are called Agricultural Financial Institution Funds and the Agricultural Cooperative Modernization Funds. The agricultural cooperative's mutual credit system instructs farmers on how to use these loans and is tied into the government's agricultural and financial policy.

In 1954, cooperatives were allowed to operate in the area of insurance. Since then, the mutual insurance division of agricultural cooperatives has been significantly developed. Currently, the mutual insurance divisions, as well as the credit divisions, are the most profitable in the agricultural cooperative. Cooperatives are

engaged in several types of insurance. For example, life insurance is the most typical and consists of 60 percent of the total long-term insurance. Together the long- and short-term insurance policies amount to approximately \$6.6 trillion [Ja-zenchu 1993, 20].

Japan's 670 food cooperatives, which are subdivided into *Hans*, have about 15 million members, but their sales represent only 2.6 percent of the retail market [Japanese Consumers Co-operative Union 1992]. Although the number of these food cooperatives has remained almost constant over the last 15 years, their membership has increased by about 50 percent.

There are 122 medical cooperatives in Japan that run 81 hospitals and have 1.5 million members. One million Japanese belong to 49 housing cooperatives. Forty percent of all students, faculty, and staff at Japanese universities belong to one of the 181 university co-ops.

Currently, Japan's banking industry is facing a turning point. Deregulation of interest rates has stimulated competition among banks and encouraged the industry to restructure their management. Mergers have been frequent, especially in small Shinkin credit banks and credit unions. Even Japan's city banks, which are among the largest banks in the world, have been forced to reassess their corporate and capital structure. The local banks have also experienced severe competition from city banks and smaller banks empowered by mergers. Additionally, an increase in bad debts and the need to meet international capital standards of adequacy have caused banks to think seriously about restructuring.

There are several types of banks for small- and medium-sized businesses: the second local banks (small commercial banks), Shinkin credit banks, and credit unions. The 440 Shinkin banks' customer bases are smaller than that of the second local banks. In 1951, the Shinkin Credit Bank Law was passed, and the banks began operation as the more commercialized credit unions under the control of the Ministry of Finance. The customer base is composed of owners of small businesses and residents of the area in which the banks are located. The membership requirements for businesses state they must have less than \$1.76 million in capital and fewer than 300 workers. However, with regards to individual depositors, there are no requirements or limitations. Although the customer base is smaller, they function as financial institutions in ways identical to larger banks.

Credit unions are cooperative financial institutions that more closely approximate what are known in the United States as credit unions. In 1949, a cooperative law was passed to develop small firms. Unlike Shinkin credit banks, the 402 credit unions' depositors and borrowers have to be members. The membership for businesses requires they have less than \$840,000 in capital and fewer than 300 workers.

Mounting bad debts are typical problems for the entire banking industry. Under such conditions, most of the banks' profits have decreased for three consecutive years. In 1992, the total revenue of the industry was \$530 billion, down 5.5 percent when compared with the previous year. The total profit was \$23.9 billion, down by 5.2 percent. After-tax revenue was \$11.7 billion, down by 23 percent [*Nikkei Shinbun* 1992b].

The small financial institutions, such as the second local banks, Shinkin credit banks, and credit unions, are operating under the most severe conditions.² Moreover, the difficulties of management have led often to fraud. Another result of poor management is a high bad-debt rate, with the bad debts primarily those of small business customers. Shinkins and credit unions have less convenience for customers. For example, they have far fewer branches or ATMs compared with city banks and local banks. In addition, these small banks or credit unions are usually less computerized.

Therefore, most of the Shinkins and credit unions have been considering mergers or being acquired as a strategy to overcome difficulties. The number of mergers have been increasing rapidly among the Shinkins and credit unions. Furthermore, some credit unions cannot continue their business by themselves because of increasing bad debts or fierce competition. Government policy is to protect depositors and creditors. In addition, most smaller banks, such as Shinkins and credit unions, are affiliated to major banks, such as city banks, in the so-called "keiretsu." Under this system, when it is impossible for those banks to continue their businesses, city banks or local banks offer support. In the case of Toyo Shinkin, Sanwa bank, which is the headquarters of the affiliated Industrial Bank of Japan (IBJ), and Tokai Bank have paid the Toyo Shinkin's debt. The amount paid by IBJ and Tokai Bank was \$2.4 billion [*Nikkei Shinbun* 1992c].

The future of many individual Shinkins and credit unions is not promising. Mergers and acquisitions are likely to increase at a faster pace, especially considering the current recession. Of 57

credit unions in the Tokyo prefecture, 60 percent have deposits of less than \$4.2 million, and 70 percent are considering mergers [*Nikkei Shinbun* 1992a].

Conclusion

The Japanese cooperative sector is a diverse and generally strong part of the economy. However, the current recession, deregulation, and an easing of trade barriers on agricultural goods mean this sector faces difficulties. The market power of cooperatives in agriculture and the vast amount of assets under their control will provide some leverage to handle hard times. The agricultural cooperatives' strength mirrors somewhat the U.S. situation. Agricultural cooperatives in the United States are strong—a few are even in the Fortune 500, but the average 23 percent market share they enjoy for all farm products is dwarfed by the market share for a wide range of farm and farm-related products that Japanese cooperatives enjoy [Cropp and Ingalsbe 1989]. The agricultural cooperatives in Japan, unlike those in the United States, undertake a wide range of services and projects (e.g., insurance, financing, forestry, welfare, and packaging) and act as if they were government rural development agencies.

The diversity of Japanese cooperatives and of the services they provide suggests that some of these cooperatives will continue to thrive. The diversity of services (e.g., food retail, medical, housing, and university cooperatives) is similar to the range of industries where cooperatives are found in the United States, but the United States has cooperatives in a few industries where they are not found in Japan, e.g., electric generation and distribution, telephone, and cable TV [Rock and Klinedinst 1992].

The credit unions in Japan face the greatest difficulty. Their numbers will likely decline due to deregulation, the current recession, increasing competition from banks, and mergers. If current trends continue, although their numbers will go down, membership should go up (e.g., a 32 percent increase in Shinkin membership for 1982-1992). These trends are similar to those facing U.S. credit unions. Credit unions are much more numerous in the United States (about 14,000 versus under 1,000 for Shinkins and smaller credit unions in Japan), but they so far have been more resistant to the recession and competition from banks [Klinedinst and Rock 1993-1994].

In summary, Japanese cooperatives are diverse and often strong economic organizations. The current recession, deregulation, and the lifting of some trade barriers are likely to adversely affect a number of cooperatives. The current reliance on the strength of the agricultural sector needs to be balanced with ventures into other industries. The future of cooperatives in Japan may in large part be determined by the attempt to train the leadership with better management skills, complemented with an effort to make these cooperatives more fully democratic.

Notes

1. If insurance policy holders are included, this number would swell to approximately 63 million members, or roughly 50 percent of the total population.
2. Forged CDs at the Toyo Shinkin bank have been recently disclosed, and this scandal also proved to involve the Industrial Bank of Japan (IBJ). It was, according to the view of the authorities, the main bank of Nui Onoue, the Osaka-based restaurant owner to whom a Toyo Shinkin employee issued the forged CDs. IBJ is considered to be responsible because on four separate occasions its Osaka branch released collateral to Ms. Onoue in the form of its own debentures, which she had lodged at the bank to back the \$2 billion she borrowed from the IBJ group. Ms. Onoue substituted the phony Toyo Shinkin CDs as collateral and used the IBJ debentures temporarily in her possession to borrow elsewhere. She has since pleaded guilty to fraud [*Economist* 1992].

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